

## Message Text

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61/46

ACTION EA-14

INFO OCT-01 ISO-00 FEA-02 INT-08 FPC-01 AID-20 CIAE-00

COME-00 EB-11 FRB-02 INR-10 NSAE-00 RSC-01 TRSE-00

XMB-07 OPIC-12 SPC-03 CIEP-02 LAB-06 SIL-01 OMB-01

SAM-01 NSC-10 SS-20 STR-08 CEA-02 DODE-00 PA-04

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R 301031Z JAN 74

FM AMEMBASSY TAIPEI

TO SECSTATE WASHDC 798

INFO AMCONSUL HONG KONG

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C O R R E C T E D C O P Y -- TEXT --

E.O. 11652: N/A

TAGS/ ECON, TW

SUBJECT: GRC ANNOUNCES ECONOMIC STABILIZATION MEASURES

REF: TAIPEI 384, 420, 512

1. SUMMARY: GRC ANNOUNCED SWEEPING ECONOMIC STABILIZATION MEASURES JANUARY 26, INCLUDING LARGE (IN MANY CASES 80-90 PERCENT) PRICE INCREASES IN PETROLEUM PRODUCTS, ELECTRICITY AND TRANSPORTATION, STEEP INCREASES IN INTEREST RATES BOTH ON DEPOSITS AND LOANS, AS WELL AS WAGE INCREASE OF 10 PERCENT FOR CIVILIAN AND MILITARY GOVERNMENT PERSONNEL. ECONOMIC AND POLITICAL EFFECTS OF PROGRAM WILL NOT BE KNOWN FOR SOME TIME.

2. ALTHOUGH SKILL AND CARE SEEM REFLECTED IN COMPREHENSIVE PROGRAM, GOVERNMENT IS GAMBLING ON ITS "ONE BITE" APPROACH AS BEST WAY TO COUNTER INFLATIONARY PSYCHOLOGY. GREATEST  
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UNCERTAINTY, IN OUR VIEW, IS ABILITY TO HOLD LINE ON

LIVING COSTS AND WAGES OF LOWER INCOME GROUPS. SO FAR, WE HAVE RUN ACROSS CONSIDERABLE GRUMBLING FROM MANY ELEMENTS OF SOCIETY. HOWEVER, THIS SHOULD NOT POSE SERIOUS PROBLEM FOR GRC UNLESS ITS STABILIZATION MEASURES FAIL. END SUMMARY.

3. FOR FIRST TIME IN MANY YEARS INFLATION BECAME SERIOUS PROBLEM FOR ROC IN 1973. TRIGGERED BY HIGH PRICES, SHORTAGES OF ESSENTIAL AGRICULTURAL COMMODITIES AND INDUSTRIAL RAW MATERIALS, AND THEN FED BY OIL CRISIS, AVERAGE WHOLESALE PRICES INCREASED BY 23 PERCENT OVER 1972 LEVEL AND CONSUMER PRICES REGISTERED 13 PERCENT INCREASE. PRICES WOULD HAVE GONE EVEN HIGHER HAD NOT GRC ABSORBED MANY OF THE INCREASED COSTS BY SUBSIDIES TO IMPORTERS OF AGRICULTURAL COMMODITIES AND WRITE-OFFS OF LOSSES SUFFERED BY GRC-OWNED ENTERPRISES SUCH AS CHINA PETROLEUM CORPORATION (CPC) AND TAIWAN POWER COMPANY (TPC). IN ADDITION TO PRICE PRESSURES, MONEY IN CIRCULATION INCREASED BY ALMOST 50 PERCENT AS RESULT OF LARGE WAGE INCREASES, REDUCED SAVINGS AND STRONG DEMAND FOR CONSUMER GOODS.

4. ALTHOUGH UNDER CONSIDERATION FOR SOME TIME, (RFFTELS) ECONOMIC STABILIZATION MEASURES ANNOUNCED JANUARY 26 WERE DEFERRED FOR PSYCHOLOGICAL REASONS UNTIL IMMEDIATELY AFTER CELEBRATION OF LUNAR NEW YEAR. MEASURES ARE DESIGNED TO PASS ON TO GENERAL PUBLIC AND INDUSTRIAL SECTOR INCREASED COSTS OF IMPORTS OF AGRICULTURAL COMMODITIES AND INDUSTRIAL RAW MATERIALS, THEREBY REDUCING BUDGETARY EXPENDITURES PAID OUT IN SUBSIDIES AND ABSORPTION OF LOSSES, AND TO REDUCE RATE OF INFLATION BY ENCOURAGING SAVINGS, REDUCING DEMAND FOR COMMERCIAL LOANS AND, IN GENERAL, CONTRACTING MONEY SUPPLY:

A. FUEL PRICE INCREASES REFLECT 300 PERCENT PRICE INCREASE OF CRUDE DURING SEPT-DEC. 1973. PRICE OF GASOLINE WAS INCREASED JAN. 27 AN AVERAGE OF 85 PERCENT, DIESEL FUEL PRICE 50 PERCENT AND FUEL OIL PRICE 94 PERCENT. MAJOR USERS OF PETROLEUM PRODUCTS WERE PERMITTED TO PASS ON THESE INCREASED FUEL COSTS. RAILROAD PASSENGER FARES LIMITED OFFICIAL USE

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WERE INCREASED FROM 30 TO 60 PERCENT, PERCENTAGE DEPENDING ON CLASS OF SERVICE; RAILROAD FREIGHT RATES WENT UP 32 TO 50 PERCENT; INTER-CITY BUS FARES WERE INCREASED BY 32 TO 50 PERCENT, AMOUNT OF INCREASE AGAIN DEPENDING ON CLASS OF SERVICE; AND DOMESTIC AIR PASSENGER FARES WENT UP 77 PERCENT. LOCAL BUS FARES WERE INCREASED BY 66 PERCENT. STUDENTS WILL BE ALLOWED TO TRAVEL AT THE OLD FARES. AS MAJOR CONSUMER OF FUEL OIL, TPC WAS ALSO PERMITTED SHARP

RATE INCREASES BASED ON PRINCIPLE OF "THE MORE YOU USE, THE MORE YOU PAY". HOUSEHOLDS USING LESS THAN 100 KWH PER MONTH WILL PAY NOTHING ADDITIONAL WHILE MAJOR INDUSTRIAL USERS OF ELECTRIC POWER WILL PAY UP TO AS MUCH AS 135 PERCENT MORE THAN PREVIOUSLY.

B. OTHER PRICE INCREASES - CEILING PRICES IMPOSED LAST JULY ON A LIST OF 16 COMMODITIES HAVE BEEN REPLACED BY OTHER TYPES OF CONTROLS. SO-CALLED "STABILIZED" BUT HIGHER PRICES WERE ANNOUNCED FOR WHEAT (UP 65 PERCENT) AND FOR SOYBEANS (UP 26 PERCENT). THESE PRICES, PAID BY MILLERS, ARE STILL SUBSIDIZED, BUT AT A LEVEL MUCH CLOSER TO WORLD MARKET PRICES, AND FURTHER ADJUSTMENTS WILL PROBABLY BE MADE AS CONDITIONS REQUIRE. EX-FACTORY PRICES FOR SOYBEAN POWDER AND OIL UP 27 PERCENT, WHEAT FLOUR UP 54 TO 73 PERCENT, DEPENDING ON GRADE. CEILING PRICES ON OTHER COMMODITIES ON THE LIST, INCLUDING CERTAIN KINDS OF YARN AND CLOTH, PORK, LPG, UREA AND AMMONIA SULFATE FERTILIZER, FLAT GLASS AND CEMENT WERE REPLACED BY "NEGOTIATED PRICES", THE TYPE USED FOR KEY CONSUMER PRODUCTS INSTITUTED LAST OCTOBER. EACH INDUSTRY IS TO WORK OUT NEGOTIATED PRICE, UNTIL WHICH TIME FORMER CEILING PRICES REMAIN IN EFFECT. IT WAS ALSO ANNOUNCED THAT STOCK PILING OF ESSENTIAL COMMODITIES WILL BE CONTINUED AND THE BAN ON EXPORTS OF ITEMS IN HIGH DEMAND IN DOMESTIC MARKET ALSO WILL BE CONTINUED. FINALLY, PRICES OF WINES AND TOBACCO PRODUCTS HAVE BEEN INCREASED FROM 20 TO 50 PERCENT, DEPENDING ON THE QUALITY.

C. FINANCIAL MEASURES - INTEREST RATES HAVE BEEN RAISED SUBSTANTIALLY. SAVINGS ACCOUNTS WILL NOW PAY 9 PERCENT INSTEAD OF 6.5 PERCENT AND INTEREST ON TIME LIMITED OFFICIAL USE

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DEPOSITS WILL BE FROM 7 PERCENT TO 15 PERCENT DEPENDING ON THE DURATION OF THE DEPOSIT. INTEREST ON COMMERCIAL BANK LOANS HAS BEEN RAISED FROM 13.25 PERCENT TO 17.5 PERCENT. NO LOANS WILL BE GRANTED FOR THE CONSTRUCTION OF PRIVATE DWELLINGS OR THE ACQUISITION OF LAND FOR DEVELOPMENT. ALSO, THE (INCOMPLETELY ENFORCED) RESTRICTION ANNOUNCED IN 1973 THAT PERMITS WILL NOT BE ISSUED FOR THE CONSTRUCTION OF OFFICE AND APARTMENT BUILDINGS FIVE STORIES OR HIGHER WILL REMAIN IN FORCE.

5. GRC CAREFULLY PREPARED THE PUBLIC FOR THE SHOCK OF THE JANUARY 26 ANNOUNCEMENT. AS POINTED OUT IN TAIPEI 512, SENIOR ECONOMIC OFFICIALS, AS WELL AS THE PREMIER, HAVE BEEN QUOTED IN RECENT WEEKS ON THE NEED FOR RETRENCHMENT AND THE INEVITABILITY OF MEASURES TO

COMBAT INFLATION. PRESS HAS GIVEN HEAVY PLAY TO THEME  
INFLATION HAS BEEN RESULT OF INTERNATIONAL  
ECONOMIC FACTORS BEYOND THE GRC'S CONTROL.

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6. WHILE THE PUBLIC HAD BEEN FOREWARNED THAT UNPLEASANT  
NEWS WAS IN THE OFFING, SEVERITY OF THE MEASURES WAS  
UNEXPECTED. THEIR IMPACT WILL BE FELT IN ALL SECTORS  
OF THE ROC ECONOMY AND IN ALL STRATA OF SOCIETY.  
IMMEDIATE IMPACT OF THE PRICE INCREASES IS TO DECREASE THE  
PURCHASING POWER OF THE WAGE EARNER. TO SOFTEN BLOW FOR  
POLITICALLY SENSITIVE ELEMENTS, GRC ANNOUNCED A  
10 PERCENT PAY INCREASE FOR OFFICIAL, MILITARY AND  
CIVILIAN PERSONNEL, ALSO GRANTED ONE MONTH'S NEW YEAR'S  
BONUS, A PRACTICE SUSPENDED ONLY LAST YEAR, AND FURTHERMORE  
PROMISED ACROSS THE BOARD INCREASE AGAIN  
BEGINNING JULY 1, FY-1975, MINISTER OF FINANCE TOLD  
ASST. SECRETARY INGERSOLL SIMILAR PAY INCREASES IN THE  
PRIVATE SECTION WILL BE UNAVOIDABLE.

7. COMMENT: PREMIER CHIANG AND HIS ECONOMIC MINISTERS HAVE  
STRESSED THEIR CONVICTION THAT "ONE BITE" APPROACH WAS

BEST WAY TO COPE WITH INFLATIONARY PSYCHOLOGY. THEY HAVE ANNOUNCED THAT THEY CONTEMPLATE NO FURTHER PRICE INCREASES IN 1974, AND DESPITE DISLOCATION OF SEEPING MEASURES, THEY LIMITED OFFICIAL USE

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BELIEVE THEIR APPROACH IS MORE LIKELY TO AVOID CREEPING INFLATION THAN PIECEMEAL STEPS. THEY FEAR LATTER WOULD ONLY INDUCE CONSUMERS TO FOREGO SAVINGS AND CONVERT MONEY INTO CONSUMER GOODS THEREBY MAGNIFYING INFLATIONARY PROBLEM. BY ABSORBING LARGER SHARE OF CONSUMER EXPENDITURE INTO GOVERNMENT SUPPLIED NECESSITIES AND INDUCING HIGHER SAVINGS BY RAISING INTEREST RATES GOVERNMENT HOPES REDUCE AGGREGATE DEMAND.

8. FULL POLITICAL AND ECONOMIC EFFECTS OF STABILIZATION PROGRAM OBVIOUSLY WILL NOT BE KNOWN FOR SOME TIME. INITIAL REACTIONS FROM SIGNIFICANT SAMPLING OF US AND CHINESE BUSINESSMEN ARE DECIDEDLY BEARISH. THEY ARE CONCERNED THAT INEVITABLE WAGE INCREASES PLUS PRICE INCREASES IN PETROLEUM PRODUCTS AND POWER WILL RESULT IN MAJOR COST INCREASES IN MANUFACTURES. THERE COULD BE A SIGNIFICANT DROP IN EXPORTS IN 1974 AS THEY BECOME LESS COMPETITIVE IN WORLD MARKETS AND DOMESTIC DEMAND MAY DECLINE AS PURCHASING POWER DECLINES AND SAVINGS INCREASE.

9. PROGRESSIVE NATURE OF PRICE INCREASES BEAR OUT PREMIER'S STATED INTENTION TO EASE BURDEN ON LOW INCOME GROUP. NEVERTHELESS HASTY SAMPLE OF MAN-ON-THE-STREET REACTIONS HAS UNCOVERED EXTENSIVE GRUMBLING ABOUT COST OF LIVING INCREASES CAUSED NOT ONLY BY ANNOUNCED PROGRAM BUT BY BLACKMARKETING OF CONTROLLED ITEMS, AND BY GENERAL PRICE INCREASES WHICH ARE OCCURRING THROUGHOUT ECONOMY. MOST PEOPLE SEEM TO RECOGNIZE THAT PROBLEM IS EXTERNALLY STIMULATED, AND THE GOVERNMENT SEEMS SO FAR TO BE ESCAPING HEAVY CRITICISM.

10. INITIAL PESSIMISM OF BUSINESS COMMUNITY NOTWITHSTANDING, EMBASSY BELIEVES GRC HAS GROUNDS FOR ITS ASSUMPTION THAT ECONOMY WILL CONTINUE TO GROW IN 1974, ALTHOUGH AT A REDUCED RATE COMPARED WITH 1973. STABILIZATION MEASURES WERE BASED ON THOROUGH ANALYSES OF ROC ECONOMY AND ECONOMIES OF THE ROC'S MAJOR TRADING PARTNERS AND ESTIMATES AS TO WHAT ROC WILL BE PAYING FOR RAW MATERIALS AT THE END OF 1974. THESE ANALYSES AND ESTIMATES COULD OF COURSE BE WRONG. MOREOVER GOVERNMENT IS GAMBLING ON ITS "ONE BITE" APPROACH. THE GREATEST UNCERTAINTY IS ITS LIMITED OFFICIAL USE

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ABILITY TO HOLD THE LINE ON LIVING COSTS AND WAGES OF  
LOWER INCOME GROUPS. GOVERNMENT FACES A DILEMMA: ON THE  
ONE HAND, HOLDING WAGES DOWN TOO FIRMLY WOULD REDUCE  
REAL INCOMES AND RISK VERY ADVERSE POLITICAL CONSEQUENCES;  
ON THE OTHER HAND, PERMITTING A LARGE RISE IN WAGE LEVELS  
WOULD UNRAVEL STABILIZATION MEASURES.  
MCCONAUGHY

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## Message Attributes

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